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TRANSCRIPT OF RECORD

SUPREME COURT OF THE UNITED STATES

OCTOBER TERM, 1930

No. 288

DAVID BURNET, COMMISSIONER OF INTERNAL REVENUE, PETITIONER

vs.

THOMPSON OIL & GAS COMPANY

ON WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE TENTH CIRCUIT

PETITION FOR CERTIORARI FILED JULY 11, 1930
CERTIORARI GRANTED OCTOBER 13, 1930

(35210)

SUPREME COURT OF THE UNITED STATES

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No. 288

DAVID BURNET, COMMISSIONER OF INTERNAL REVENUE, PETITIONER

vs.

THOMPSON OIL & GAS COMPANY

ON WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE TENTH CIRCUIT

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A

[Caption omitted.]

1 Before United States Board of Tax Appeals

Docket No. 10600

THOMPSON OIL AND GAS COMPANY, TULSA, OKLAHOMA

vs.

COMMISSIONER OF INTERNAL REVENUE

For taxpayer, Phil Morelock, Esq.; for commissioner, A. H. Fast, Esq. Mr. Trammell (member). 5-26-28.

Docket entries

1926

Jan. 4—Petition received and filed.
Jan. 11—Copy of petition served on solicitor.
Jan. 11—Notification of receipt mailed taxpayer.
Feb. 10—Answer filed by solicitor.
Feb. 15—Copy of answer served on taxpayer; assigned to field calendar.

1927

July 20—Motion to amend petition filed by taxpayer; amendment tendered.
July 22—Granted; both sides notified.
July 25—Copy of motion served on G. C.
July 22—Hearing set Oct. 27, 1927, Kansas City.
Sept. 13—Hearing date advanced to 10-14-27 at Kansas City.
Sept. 22—Motion, extension 9-23 to 10-23, to answer, filed by G. C.
Sept. 23—Granted; both sides notified.
Sept. 13—Answer to amend petition filed in field by G. C.
Oct. 14—Hearing had before Mr. Lansdon on merits; stipulation of facts filed; briefs due 11-13-27.
Nov. 14—Motion, for an extension to 12-10-27 to file brief, filed by G. C.
Nov. 15—Granted; both sides notified.
Dec. 3—Motion, for an extension to 1-14-28 to file brief, filed by taxpayer.
Dec. 5—Granted.
Dec. 9—Brief filed by G. C.

1928

Jan. 12—Brief filed by taxpayer.

1929

Mar. 20—Findings of fact and opinion rendered, Mr. Littleton. Judgment will be entered for the respondent.
2 Mar. 21—Decision entered.
Aug. 29—Motion to fix amount of bond filed by taxpayer ($29,838.44).

1929

Aug. 29—Motion to fix amount of bond granted.
Sept. 5—Petition for review by U. S. Cir. Ct. of Ap. (10), with assignments of error, filed by taxpayer.
Sept. 5—Proof of service filed.
Nov. 1—Agreed præcipe filed.
Nov. 1—Stipulation, as to time for certification of record enlarged to 11-19-29, filed.

Now, November 6, 1929, the foregoing docket entries certified from the record as a true copy.

[SEAL.] B. D. GAMBLE,
Clerk, U. S. Board of Tax Appeals.

Before United States Board of Tax Appeals

[Title omitted.]

Petition

Filed Jan. 4, 1926

The above-named taxpayer hereby appeals from the determination of the Commissioner of Internal Revenue set forth in his deficiency letter (IT:E:SM-60D GM-16670, A-16689) dated November 14, 1925, and as the basis of its appeal sets forth the following:

JURISDICTION OF THE BOARD

1. The taxpayer is an Oklahoma corporation, with its principal office at Tulsa, Oklahoma.

2. The deficiency letter (copy of which is attached) was mailed to the taxpayer on November 14, 1925, and states a deficiency of $29,838.44.

3. The taxes in controversy are income and profits taxes for the calendar year 1918 and are less than $10,000, to wit, $6,824.59.

ASSIGNMENTS OF ERROR

4. The determination of tax contained in the said deficiency letter is based upon the following errors:

3 (a) The Commissioner of Internal Revenue has computed the profits tax for the calendar year 1918 under the provisions of section 328 of the revenue act of 1918 as 47.5% of the statutory net income, said profits tax amounting to $27,470.11 whereas it is thought that the rate of excess profits tax should be between 35% and 40% of said statutory net income, or approximately $23,101.62.

(b) A list of competitors has been submitted for use as comparatives, but it is not known whether such list was considered in the computation of the profits tax by the commissioner. Furthermore, the commissioner has not disclosed the comparative data upon which he has based the computation of the profits tax.

STATEMENT OF FACTS

5. The corporation is engaged in the production of oil. The statutory invested capital of the corporation could not be determined satisfactorily, and the commissioner has passed favorably upon the application of the corporation under the provisions of section 327 of the revenue act of 1918 for the computation of its profits taxes for the year 1918 under the provisions of section 328 of the revenue act of 1918. The statutory net income agreed upon amounted to $57,754.06. The profits tax as computed by the commissioner amounts to $27,470.11, or 47.5% of the agreed statutory net income.

PROPOSITION OF LAW

6. The taxpayer in support of its appeal relies upon the following proposition of law: Section 328 of the revenue act of 1918.

Wherefore the taxpayer respectfully prays that this board may hear and determine its appeal.

PHIL D. MORELOCK,
Of Shouse, Doolittle & Morelock,
710 Land Bank Building, Kansas City, Missouri,
Counsel for Taxpayer.

[*Duly sworn to by A. F. Bourne; jurat omitted in printing.*]

4 *Deficiency letter*

TREASURY DEPARTMENT,
Washington, Nov. 14, 1925.

IT:E:SM-60D, GM-16670, A-16689.
THOMPSON OIL & GAS COMPANY,
P. O. Box 463, Tulsa, Oklahoma.

SIRS: An audit of your income and profits tax returns for the calendar years 1917 and 1918 has resulted in the determination of a deficiency in tax of $29,838.44 for the year 1918 and an overassessment of $1,786.70 for the year 1917, as shown in the attached statement.

In accordance with the provisions of section 274 of the revenue act of 1924 you are allowed 60 days from the date of mailing of this letter within which to file an appeal to the United States Board of Tax Appeals contesting in whole or in part the correctness of this determination.

Where a taxpayer has been given an opportunity to appeal to the United States Board of Tax Appeals and has not done so within the 60 days prescribed and an assessment has been made or where a taxpayer has appealed and an assessment in accordance with the final decision on such appeal has been made, no claim in abatement in respect of any part of the deficiency will be entertained.

If you acquiesce in this determination and do not desire to file an appeal, you are requested to sign the inclosed agreement consenting

to the assessment of the deficiency and forward it to the Commissioner of Internal Revenue, Washington, D. C., for the attention of IT:E:SM-60D, GM-16670, A-16690. In the event that you acquiesce in a part of the determination the agreement should be executed with respect to the items agreed to.

Respectfully,

D. H. BLAIR,
Commissioner.

By ——— ———,
Assistant to the Commissioner.

Statement

IT:E: SM-60D, GM-16670, A-16690.

In re Thompson Oil & Gas Company, P. O. Box 463, Tulsa, Oklahoma

	Deficiency in tax	Overassessment
1917		$1,786.70
1918	$29,838.44	

After a careful review of your protest dated June 27, 1925, against the result of the allowance of your application for assessment of your profits tax under the provisions of sections 210 and 328 of the revenue acts of 1917 and 1918, respectively, as set forth in bureau letter dated June 15, 1925, and of all the evidence submitted in support of your contentions at the conference held September 9, 1925, you are advised that the bureau holds that the profits tax as shown in the above-mentioned letter is representative of the rate of profits tax paid by concerns engaged in a like or similar trade or business and affords adequate relief under the provisions of sections 210 and 328 of the revenue acts of 1917 and 1918, respectively.

The deficiency in tax of $29,838.44 for 1918 and the overassessment of $1,786.70 for 1917, of which you were advised in bureau letter dated June 15, 1925, are therefore sustained.

A copy of this letter is being furnished your representatives, Shouse, Doolittle & Morelock, 710 Land Bank Building, Kansas City, Missouri, in accordance with the authority conferred by your company.

The right of appeal to the United States Board of Tax Appeals, as indicated on page one of this letter, refers only to any deficiency in tax indicated herein, inasmuch as there is no provision in the revenue act of 1924 granting the right of appeal against the determination of any overassessment found upon an audit of your returns.

6 Now, November 6, 1929, the foregoing petition certified from the record as a true copy.

B. D. GAMBLE,
Clerk, U. S. Board of Tax Appeals.

Before United States Board of Tax Appeals

Answer

Filed Feb. 10, 1926

Comes now the Commissioner of Internal Revenue, by his attorney, A. W. Gregg, Solicitor of Internal Revenue, and for answer to the petition filed in the above-entitled appeal admits and denies as follows:

1. Admits the statements contained in paragraphs 1, 2, and 3 of the petition.

2. Admits the statement of fact contained in paragraph 5.

PROPOSITION OF LAW

1. The taxpayer is not entitled to any other or further relief in the computation of its profits taxes than has been determined by the commissioner.

Wherefore it is prayed that the taxpayer's petition be dismissed and the appeal denied.

A. W. GREGG,
Solicitor of Internal Revenue,
Attorney for Commissioner of Internal Revenue.

Of counsel:
WARD LOVELESS,
Special Attorney, Bureau of Internal Revenue.

Now, November 6, 1929, the foregoing answer certified from the record as a true copy.

[SEAL.] B. D. GAMBLE,
Clerk, U. S. Board of Tax Appeals.

Before United States Board of Tax Appeals

Amended petition

The above-named petitioner hereby admits for the consideration of the board in the determination of this cause the following amended petition:

1. The petitioner is an Oklahoma corporation with its principal office at Tulsa, Oklahoma.

7 2. The deficiency letter (copy of which was attached to the original petition) was mailed to the petitioner on November 14, 1925, and stated a deficiency of $29,838.44.

3. The taxes in controversy are income and profits taxes for the calendar year 1918 and are for $5,010.63.

4. The determination of the tax contained in the said deficiency letter is based upon the following errors:

(a) The Commissioner of Internal Revenue has added the cost of lease, amounting to $30,000, in 1916, and has also added 300,000 barrels to the reserves of oil in 1916, whereas the commissioner should have added the 300,000 barrels of oil to the March 1, 1913, reserves as computed and then added the $30,000 paid for renewal of the lease in 1916.

(b) The Commissioner of Internal Revenue has reduced the March 1, 1913, value by depletion sustained from 1913 to 1916, inclusive, whereas under the law laid down by the Supreme Court in the case of U. S. v. Ludey the March 1, 1913, value should have been reduced only by the depletion allowed as a deduction from income under the 1913 and 1916 revenue acts, amounting to 5% of the gross sales of oil.

5. The facts upon which the amended petition are based follow:

(a) The petitioner operates the lease known as the Bessie and Fillie Clayton lease, SW. ¼ of SW. ¼ of section 4, township 17 north, range 12 east, in the Glenn Pool district. The original lease was acquired on August 16, 1907, and by its terms expired August 6, 1918. Contract for renewal of the lease was entered into July 15, 1916. The renewal price was $30,000. The contract of 1916 renewing the lease as at August 6, 1918, provided for ⅛ royalty instead of ⅛, as provided by the terms of the former leases.

(b) The following schedules are submitted:

1. Schedule A, showing computation of depletion by commissioner.

2. Schedule A–1, showing schedule computed by the commissioner adjusted to show depletion allowable under the 1913 and 1916 laws as provided by the Supreme Court in the case of U. S. v. Ludey.

3. Schedule B, showing the addition of $300,000 barrels reserves in 1913 and the addition of $30,000 renewal price of lease in 1916.

8 4. Schedule B–1, adjusting of Schedule B in accordance with the decision of the Supreme Court in the case of U. S. v. Ludey.

5. Schedule C, gross income and depletion deductible under the law for the years 1913 to 1916, inclusive.

Wherefore the petitioner prays that the board may hear this proceeding and grant relief as follows:

The allowance as deduction from income in 1918 of depletion in the amount of $16,056.21.

PHIL D. MORELOCK,
Counsel for Petitioner.

[*Duly sworn to by A. F. Bourne; jurat omitted in printing.*]

9 SCHEDULE A.—*Depletion schedule—March 1, 1913, value and subsequent cost*

Year	Capital sum			Reserves		Production	Depletion unit	Depletion sustained
	Beginning	Added	Total	Added	Total			
3-1-13 to 12-31-15			156,645.00		278,000	162,717	.56347	91,686.15
1916	64,958.85	30,000.00	94,958.85	300,000	415,283	49,452	.22866	11,307.69
1917	83,651.16				365,831	39,204		8,964.39
1918	74,686.77				326,627	33,097		7,705.16

Copy of Treasury Department Schedule dated 6-3-24 (IT : En : OG : VHS).

10 SCHEDULE A-1.—*Depletion schedule—March 1, 1913, value and subsequent cost*

Year	Capital sum			Reserves		Production	Depletion unit	Depletion	
	Beginning	Added	Total	Added	Total			Sustained	Deductible
3-1-13 to 12-31-15			156,645.00		278,000	162,717	.56347	91,686.15	9,262.29
1916		30,000.00		300,000	415,283	49,452	.22866	11,307.69	3,034.46
1917	[1] 174,328.25		174,328.25		365,831	39,204	.4765	18,680.71	
1918			155,647.54		326,627	33,097		16,056.21	

[1] Capital sum beginning 1917 reduced only by depletion deductible.

11 SCHEDULE B.—*Depletion schedule—March 1, 1913, value and subsequent cost*

Year	Capital sum			Reserves		Production	Depletion unit	Depletion sustained
	Beginning	Added	Total	Added	Total			
3-1-13 to 12-31-15			156,645.00		578,000	162,717	.271	44,096.31
1916	112,548.69	30,000.00	142,548.69		415,283	49,452	.3432	16,971.93
1917			125,576.76		365,831	39,204		13,454.81
1918			112,121.95		326,627	33,097		11,564.81

12 SCHEDULE B-1.—*Depletion schedule—March 1, 1913, value and subsequent cost*

Year	Capital sum			Reserves		Production	Depletion unit	Depletion	
	Beginning	Added	Total	Added	Total			Sustained	Deductible
3-1-13 to 12-31-15			156,645.00		578,000	162,717	.271	44,096.31	9,262.29
1916		30,000.00			415,283	49,452	.3432	16,971.93	3,034.46
1917	[1] 174,328.25		174,328.25		365,831	39,204	.4765	18,680.71	18,680.71
1918			155,647.54			33,097		16,056.21	16,056.21

[1] Capital sum beginning 1912 reduced only by depletion deductible.

18 SCHEDULE C.—*Gross income and depletion, 1913 to 1916, inc.*

Years	Production (bbls.)	Gross income	Depletion	
			Sustained	Deductible[1]
1913 (10 mo.)	113,393.37	102,278.18	91,686.15	5,139.09
1914	60,592.00	47,883.26		2,394.16
1915	60,667.00	34,580.89		1,729.04
1916	48,150.00	60,589.26	11,307.69	3,094.46

[1] Depletion deductible represents 5% of gross income.

Now, November 6, 1929, the foregoing amended petition certified from the record as a true copy.

[SEAL.]

B. D. GAMBLE,
Clerk, U. S. Board of Tax Appeals.

Before United States Board of Tax Appeals

Answer to amended petition

The Commissioner of Internal Revenue, by his attorney, A. W. Gregg, General Counsel, Bureau of Internal Revenue, for answer to the amended petition of the above-named taxpayers admits and denies as follows:

1. Admits the allegations contained in paragraph 1 of the petition.
2. Admits the allegations contained in paragraph 2 of the petition.
3. Admits the allegations contained in paragraph 3 of the petition.
4. Admits only that the adjustments were made, but denies that any error was made as therein alleged.
5. Admits the allegations of subparagraph (a) of paragraph 5 of the petition and that the facts stated in subparagraph (b) of said paragraph and further designated as Schedule A are true, but denies the correctness of the remaining schedules referred to in said paragraph.

Denies each and every other material allegation of fact contained in the petition.

14 Wherefore it is prayed that the taxpayer's appeal be denied.

A. W. GREGG,
General Counsel, Bureau of Internal Revenue.

Of counsel:
J. G. GIBBS,
Special Attorney, Bureau of Internal Revenue.

Now, November 6, 1929, the foregoing answer to amended petition certified from the record as a true copy.

[SEAL.]

B. D. GAMBLE,
Clerk, U. S. Board of Tax Appeals.

Before United States Board of Tax Appeals

Findings of fact and opinion

Promulgated March 20, 1929

In determining the depletion allowance deductible for 1918, under the provisions of section 234 (a) (9) of the revenue act of 1918, on account of a leasehold for the extraction of oil, which was acquired prior to March 1, 1913, and under which operations were carried on from March 1, 1913, to 1918, consideration should be given to the entire exhaustion sustained for all years, regardless of whether the whole amount of such exhaustion has been allowable as a deduction from gross income for income-tax purposes for such prior years. United States v. Ludey (274 U. S. 295) distinguished.

Phil D. Morelock, Esq., for the petitioner.

Arthur H. Fast, Esq., for the respondent.

The commissioner determined a deficiency in income and profits tax for the calendar year 1918 in the amount of $29,838.44. The issue involves the question of the correct basis for the computation of the deduction allowable from gross income for 1918 on account of depletion of oil land held and operated by the petitioner under a lease contract. The facts are stipulated.

FINDINGS OF FACT

Petitioner is an Oklahoma corporation, with its principal office at Tulsa. Prior to March 1, 1913, it acquired an oil and gas mining lease on the southwest quarter (SW. ¼) of the southwest quarter (SW. ¼) of section four (4), township seventeen (17) north, range 12 east, in Creek County, Oklahoma. The lease was an assignment of portion of a lease entered into on December 5, 1906, between Charlie Clayton, guardian of Bessie Blayton, and William McKinley Clayton, minors, as lessor, and the Indiahoma Oil Company, a corporation, as lessee, and by its terms was to expire on August 6, 1918. Under it petitioner acquired a seven-eighths (⅞) working interest, and the lessor retained a one-eighth (⅛) royalty interest.

15. July 15, 1916, an agreement in writing was entered into between P. B. France, guardian of Bessie Clayton and William McKinley Clayton, minors, as party of the first part, and the petitioner, as party of the second part, wherein, for a consideration of $30,000 paid by petitioner, the original lease was altered in that it was "extended so as to provide, in addition to the other provisions therein, that said lease shall extend and be and remain in force" on said land "until August 6, 1918, as provided in the original lease and as long thereafter as oil and gas is produced * * * in paying quantities." Also the royalty rate was changed from one-eighth to one-sixth, effective July 1, 1916.

Petitioner's oil reserve at March 1, 1913, to be recovered under the lease of December 5, 1906, prior to its termination on August

6, 1918, was 278,000 barrels, and the March 1, 1913, value of such recoverable reserve, including the value of physical equipment then on the property, was $176,645. Of this value $20,000 represented the value of the equipment and $156,645 represented the value returnable through depletion. The increase in the petitioner's ultimate recoverable oil reserve by reason of the agreement of July 15, 1916, was 300,000 barrels.

In determining the depletion allowances for the petitioner the commissioner prepared a depletion schedule wherein he used the March 1, 1913, value of $156,645, and a recoverable reserve as of March 1, 1913, of 278,000 barrels. This resulted in a depletion unit of $.56347 per barrel for the years 1913, 1914, and 1915. To obtain the remaining March 1, 1913, value to be recovered at the beginning of each succeeding year, the commissioner reduced the original March 1, 1913, value each year by the depletion actually sustained on the basis of the reserve and value established. In 1916 the commissioner added into the schedule the $30,000 consideration paid in connection with the extension of the above lease and simultaneously added the 300,000 barrels by which the petitioner's oil reserve was increased under said agreement.

The petitioner's production in barrels, its gross income, 5 per cent of the gross income, and the depletion sustained, for the years 1913, 1914, and 1915, were as follows:

Year	Production (barrels)	Gross income	5% of gross income	Depletion sustained
1913 (10 mos.)	45,808.38	$44,805.00	$2,244.78	$91,686.15
1914	61,343.53	48,450.00	2,422.50	
1915	55,565.12	33,095.44	1,654.77	
	162,717.03	126,440.44	6,322.02	

16 The following schedule was prepared by the commissioner in determining the depletion allowance for 1918:

CAPITAL SUM

Year	Beginning of year	Added during year	Total for year
3-1-13 to 12-31-15	$156,645.00		$156,645.00
1916	64,958.85	$30,000	94,958.85
1917	83,651.16		
1918	74,686.77		

RESERVES (BARRELS)

Added during year	Total for year	Production (barrels)	Unit cost	Depletion sustained
278,000	278,000	162,717	$.56347	$91,686.15
300,000	415,283	49,452	.22866	11,307.69
	365,831	30,204		8,964.39
	326,627	33,607		7,705.16

OPINION

LITTLETON. The issue concerns the proper basis for computing the deduction from gross income allowable for the year 1918 on account of depletion of oil land operated by the petitioner under a lease contract.

The revenue act of 1918 provides in material part as follows:

"SEC. 234. (a) That in computing the net income of a corporation subject to the tax imposed by section 230 there shall be allowed as deductions

* * * * * * *

"(9) In the case of mines, oil and gas wells, other natural deposits, and timber, a reasonable allowance for depletion and for depreciation of improvements, according to the peculiar conditions in each case, based upon cost including cost of development not otherwise deducted: Provided, That in the case of such properties acquired prior to March 1, 1913, the fair market value of the property (or the taxpayer's interest therein) on that date shall be taken in lieu of cost up to that date: * * *"

17 The controversy arises as the result of a limitation in the revenue act of 1913 with respect to the depletion allowable as a deduction from gross income for income-tax purposes. A part of the stipulation which we did not incorporate in our findings is this statement: "For the years 1913, 1914, and 1915, which were taxed under the 1913 act, the depletion allowance could not exceed '5 per centum of the gross value at the mine of the output for the year for which the computation is made.'" It is further shown that 5 per cent of the gross income from March 1, 1913, to December 31, 1915, was $6,322.02, whereas the depletion sustained for this period was $91,686.15, and the argument presented by both parties proceeds on the theory that the depletion allowable as a deduction from March 1, 1913, to December 31, 1915, was $6,322.02. Our consideration of the issue presented will, accordingly, be based on this agreement of the parties that the depletion allowable to the petitioner as a deduction from gross income from March 1, 1913, to December 31, 1915, was $6,322.02, whereas the depletion sustained during this period on the March 1, 1913, value was $91,686.16.

When the commissioner came to determine the depletion allowance for the year 1918, he took the March 1, 1913, value of the recoverable oil reserve at March 1, 1913, $156,645, and the oil reserve at this time of 278,000 barrels as a starting point. From this he determined a depletion unit of 56.347 cents per barrel. The production from March 1, 1913, to December 31, 1915, was 162,717 barrels, or a reduction in the March 1, 1913, value of the oil reserve of $91,686.15. In 1916 there was an additional cost of $30,000 and an addition to the oil reserve of 300,000 barrels. On account of this additional cost and the addition to the oil reserve, the commissioner found it necessary to determine a new depletion unit on the basis of the oil yet to be recovered in 1916, the March 1, 1913, value which remained un-

depleted at this time and the additions which were made at this time in cost and in the quantity of oil to be recovered. The value to be recovered in 1916 was determined by deducting from the March 1, 1913, value of $156,645 the depletion sustained from March 1, 1913, to December 31, 1915, $91,686.15, and adding to this remainder the additional cost in 1916 of $30,000, which showed a capital sum yet to be recovered of $94,958.85. The recoverable oil in 1916 was similarly determined; that is, from the oil reserve in 1913, 278,000 barrels, was deducted the oil produced from March 1, 1913, to December 31, 1915, 162,717 barrels, and to this remainder was added the addition to the oil reserve in 1916 of 300,000 barrels, which showed oil yet to be recovered in the amount of 415,283 barrels. The
18 depletion unit was then arrived at by dividing the remaining recoverable value by the remaining recoverable oil, which produced a unit of 22.866 cents per barrel. No additions are shown to cost or the oil reserve from 1916 to 1918. To obtain the allowance for depletion sustained for 1916, 1917, and 1918, the production in each of those years was multiplied by the depletion unit of 22.866 cents shown above; that is, for 1918 the depletion allowance determined and allowed by the commissioner was $7,705.16, which was obtained by multiplying the oil produced in 1918, 33,697 barrels, by the depletion unit of 22.866 cents.

The precise and specific question raised on account of the foregoing allowance is whether, in determining the depletion unit applicable to the year 1918, the action of the commissioner was correct in reducing the recoverable leasehold value by the depletion sustained from March 1, 1913, to December 31, 1915, or whether, as the petitioner contends, such recoverable value should be reduced only by the depletion which the parties have agreed the petitioner was entitled to take as a deduction from gross income in its income-tax returns for those years. At the outset it should be observed that no particular method is outlined for determining the depletion allowance under section 234 (a) (9), supra, the controlling principle being that it shall be reasonable, nor are we interested in the means by which this end is accomplished. Our questions then are: Did the commissioner determine a reasonable allowance? And, if not, will such result be obtained by following the petitioner's contention?

That a reasonable allowance for the depletion of a wasting or exhaustible asset, such as we have here, will be obtained by considering that the recoverable value will become exhausted in the same ratio as that which gives value to the asset disappears can hardly be questioned. (Lynch v. Alworth-Stephens Co., 267 U. S. 364.) For example, if at January 1, 1917, a taxpayer had purchased a leasehold for the recovery of oil at a cost of $100,000 with oil to be recovered of 400,000 barrels, and if, during 1918, 100,000 barrels had been produced, a depletion allowance of $25,000, or 25 cents per barrel, would certainly be accepted as the reasonable depletion allowance for 1918. Nor do we understand that the petitioner would deny that the foregoing result is in full compliance with the statute, pro-

vided the full exhaustion in 1917 was likewise deductible. But the petitioner, in effect, says that the foregoing method would not be correct if there had been a limitation in a statute applicable to 19 1917 on account of which the full depletion sustained for 1917 had not been allowable as a deduction from gross income for 1917, and, it seems to us, contends further that whatever depletion was sustained in the prior year which was not allowable as a deduction from gross income in such year should effectually be allowed as a part of the depletion deductions in later years to the end that when the asset is finally depleted its full capital value may have been allowed as deductions from gross income. We find nothing in the statute which justifies this conclusion. What the statute provides for is a reasonable allowance, and we can not interpret this to mean more than a reasonable allowance based upon the exhaustion which occurred during a given year. To follow the petitioner's theory would be to say that the exhaustion which occurred from March 1, 1913, to December 31, 1915, of approximately $85,000, which, the parties have agreed, was not an allowable deduction in those years, should be added to deductions which are allowable on account of exhaustion which occurred in later years. This theory is unsound. It may well be that under the limitations set out in the 1913 act the full capital cost or March 1, 1913, value will never be recovered as a deduction in the form of a depletion allowance, but a limitation was expressly provided by the 1913 act and its constitutionality has been upheld. (Stanton v. Baltic Mining Co., 240 U. S. 103.) We find nothing in the 1918 act, under which we are making our determination in this case, which would permit a greater depletion allowance in a given year than that based on the exhaustion which occurred in such year. When exhaustion of the capital value occurred from March 1, 1913, to December 31, 1915, of $91,686.15 and the petitioner was entitled to deduct only $6,322.02 of this amount, the excess which the petitioner was not entitled to deduct had as truly disappeared from the capital value as if it had been allowed as a deduction.

Nor can we agree that the case of United States v. Ludey (274 U. S. 295), on which the petitioner relies, supports its position. That case involved the gain or loss on the sale of capital assets under the revenue act of 1917 and had for one of its questions the adjustment which should be made to cost, or the March 1, 1913, value on account of depreciation and depletion from date of acquisition, or March 1, 1913, to the date when the assets were disposed of. The court held that:

"* * * Congress doubtless intended that the deduction to be made from the original cost should be the aggregate amount which the taxpayer was entitled to deduct in the several years."

20 This decision, however, related to an entirely different section of the statute from that which we are now considering. Here we are concerned with the reasonable allowance for depletion in a given year, and not with the gain which may be realized

or loss sustained when the asset is ultimately disposed of. It is true that the court made the following statement in the Ludey case with respect to the theory of depletion:

"The depletion charge permitted as a deduction from the gross income in determining the taxable income of mines for any year represents the reduction in the mineral contents of the reserves from which the product is taken. The reserves are recognized as wasting assets. The depletion effected by operating is likened to the using up of raw material in making the product of a manufacturing establishment. As the cost of the raw material must be deducted from the gross income before the net income can be determined, so the estimated cost of the part of the reserve used up is allowed. * * *"

But this statement of the court can not be interpreted as meaning that because there was a gradual sale in one year, in the form of depletion sustained which is a proper charge against manufacturing operations for such year, a part of such depletion allowance is chargeable against the operations of another year, or that a reasonable allowance for a given year on account of depletion contemplates something other than the exhaustion which occurred in such year. In fact to grant what the petitioner is asking would be giving to it in the taxable year that which the parties are agreed the statute expressly prohibited it from taking in such earlier years and when we find nothing in the statute to permit such a deduction.

In view of the foregoing, we are of the opinion that in determining the depletion allowance for 1918 the commissioner was correct in taking into consideration the actual depletion sustained from March 1, 1913, to December 31, 1915, regardless of the depletion which was allowable as a deduction for income tax purposes in those years.

The original petition also contained an assignment of error with respect to the rate applied by the commissioner in his determination of petitioner's profits tax under the provisions of section 328 of the revenue act of 1918, but no evidence was introduced on account thereof nor was this error included in the amended petition or urged in the brief filed by the petitioner.

21

Reviewed by the board.

Judgment will be entered for the respondent.

Trussell, Green, and Van Fossan dissent.

Dissenting opinion

TRAMMELL, dissenting: The deduction allowed for depletion in the case of mines is a special application of the general rule of the statute allowing a deduction for exhaustion of property. (Lynch v. Alworth-Stephens Co., 267 U. S. 364.) The end sought in an exhaustion allowance is to have the capital sum invested in a wasting asset returned to the taxpayer as a charge against receipts annually realized from the asset and in this way avoid taxing a return of capital.

The entire amount of such receipts is not taxable, but only so much thereof as does not represent a return of capital. (Edith Andrews Logan, 12 B. T. A. 686.) In essence, the deduction for depletion does not differ from the deduction for depreciation, and the proviso limiting the amount of such deductions to the amount of the capital invested shows that such deductions are to be regarded as a return of capital. (United States v. Ludey, 274 U. S. 295.)

In the case of oil wells operated by a lessee, the value of the lease contract is at all times in proportion to the recoverable oil content. As the oil is pumped out the value of the lease is correspondingly diminished, so that when the oil reserve is fully exhausted the value of the lease is likewise exhausted, and no part of the capital asset remains. The process is comparable to the gradual sale of the lease in units measured by the barrels of oil recovered and sold. The proceeds from the sale of the oil represent in part a return of capital and in part taxable income.

In United States v. Ludey, supra, the court in the course of its opinion said:

"The depreciation charge permitted as a deduction from the gross income in determining the taxable income of a business for any year represents the reduction, during the year, off the capital assets through wear and tear of the plant used. The amount of the allowance for depreciation is the sum which should be set aside for the taxable year, in order that, at the end of the useful life of the
22 plant in the business, the aggregate of the sums set aside will (with the salvage value) suffice to procide [provide] an amount equal to the original cost. The theory underlying this allowance for depreciation is that by using up the plant a gradual sale is made of it. The depreciation charged is the measure of the cost of the part which has been sold. When the plant is disposed of after years of use, the thing then sold is not the whole thing originally acquired. The amount of the depreciation must be deducted from the original cost of the whole in order to determine the cost of that disposed of in the final sale of properties. Any other construction would permit a double deduction for the loss of the same capital assets.

* * * * * * *

"The depletion charge permitted as a deduction from the gross income in determining the taxable income of mines for any year represents the reduction in the mineral contents of the reserves from which the product is taken. The reserves are recognized as wasting assets. The depletion effected by operation is likened to the using up of raw material in making the product of a manufacturing establishment. As the cost of the raw material must be deducted from the gross income before the net income can be determined, so the estimated cost of the part of the reserve used up is allowed."

In the Ludey case the court had before it the question of whether a gain was realized or a loss sustained upon the sale in 1917 of oil-mining properties, and the solution of the question depended primarily on whether deductions for depletion and depreciation were to be made from the original cost. The property consisted, besides mining equipment, in part of oil land held in fee and in part of oil-mining leases, which had been owned and operated by Ludey for several years. The tax in controversy was computed on the basis of cost reduced by the full amount of depreciation and depletion sustained, whether or not allowable by law as a deduction from gross income in past years, and the Government contended that this was the correct basis for the computation. On the other hand, Ludey contended that the correct basis for determining gain or loss on the sale of his property was original cost reduced by an amount not in excess of the deductions actually claimed by and allowed to him during the years from 1913 to 1916 on account of depletion and depreciation, without regard to the amount he was entitled to deduct under the law. The court declined to accept either contention, saying:

23 "Congress doubtless intended that the deduction to be made from the original cost should be the aggregate amount which the taxpayer was entitled to deduct in the several years."

In accordance with the foregoing rule, if the petitioner in this proceeding had sold its oil-mining lease in 1918, the basis for determining gain or loss on such sale would have been the March 1, 1913, value, less the aggregate amount which it was entitled to deduct in the preceding years on account of depletion, without regard to either the amount of the depletion actually sustained or the amount of the deductions actually claimed and allowed.

This being the sound rule for determining gain or loss on the sale of the whole property, I am unable to perceive any fundamental distinction in the case of a gradual sale of the property through depletion.

I am further impelled to this view by the fact that the application of this rule will provide an equitable method by which the entire amount of the petitioner's capital investment may be returned to it through depletion allowances, tax free, which, as pointed out above, is the manifest purpose of the statutory provisions for all exhaustion allowances. This, in my opinion, will provide, as required by the statute, a reasonable allowance for depletion according to the peculiar conditions in this case.

The aggregate amount which the petitioner herein was entitled to deduct from gross income for the years 1913, 1914, and 1915 as depletion allowances was $6,322.02. It is my opinion therefore that the correct depletion unit to be used in computing the petitioner's depletion allowance for 1918 should be determined by reducing the agreed March 1, 1913, value (which, under the statute, must be taken in this case in lieu of original cost) by the amount of $6,322.02,

the amount of depletion which the petitioner was entitled to deduct, instead of the amount of $91,686.15.

Lansdon and Siefkin agree with this dissent.

Now, November 6, 1929, the foregoing findings of fact and opinion certified from the record as a true copy.

[SEAL.] B. D. GAMBLE,
Clerk, U. S. Board of Tax Appeals.

24 Before United States Board of Tax Appeals

Decision

Pursuant to the board's findings of fact and opinion, promulgated March 20, 1929, it is ordered and decided that there is a deficiency of $29,838.44 for the year 1918.

Entered Mar. 21, 1929.

(Signed) B. H. LITTLETON,
Member, United States Board of Tax Appeals.

Now, November 6, 1929, the foregoing decision certified from the record as a true copy.

B. D. GAMBLE,
Clerk, U. S. Board of Tax Appeals.

Before United States Board of Tax Appeals

Notice of petition for review

Filed September 5, 1929

To the Commissioner of Internal Revenue, Washington, D. C.

SIR: Please take notice that the annexed is a copy of a petition filed September 5, 1929, with the United States Board of Tax Appeals for a review of its decision in the above-entitled cause by the Circuit Court of Appeals for the Tenth Circuit.

PHIL D. MONDLOCK,
Counsel for Petitioner,
815 Fifteenth Street N. W., Washington, D. C.

Receipt is acknowledged of a copy of the petition for review set forth above with notice that it was filed September 5, 1929.

R. H. LUCAS,
Commissioner of Internal Revenue,
By C. M. CHAREST,
General Counsel, Bureau of Internal Revenue.

Before United States Board of Tax Appeals

Petition for review

Filed Sept. 5, 1929

To the Circuit Court of Appeals for the Tenth Circuit:

Your petitioner, the Thompson Oil & Gas Co., respectfully shows:

25 First. This is a proceeding for review by the United States Circuit Court of Appeals for the Tenth Circuit of a decision of the United States Board of Tax Appeals, entered on March 20, 1929, and redetermining a deficiency in income and profits tax for the year 1918 against the petitioner in the sum of $29,838.44.

Second. Your petitioner is an Oklahoma corporation, with offices at Tulsa, Oklahoma. It filed its Federal income and profits tax return for 1918 with the collector of internal revenue at Oklahoma City.

Third. The nature of the controversy before the Board of Tax Appeals was the determination of income and profits taxes under the revenue act of 1918, involving a determination of the proper deduction from gross income for depletion of oil properties for the year 1918. The determination of such deduction involved the questions:

1. Whether the petitioner was entitled, through the allowance of depletion as a deduction from income, eventually to recover the full amount of the March 1, 1913, value of its oil property less the depletion which was actually allowed as a deduction from income for the years 1913 to 1915, inclusive, based on 5% of production, as provided by the revenue act of 1913.

2. Whether the respondent, in determining the base upon which the depletion allowance for 1918 should be computed, was correct in reducing the March 1, 1913, value of petitioner's oil property, fixed at $156,645.00 by depletion, sustained in the period 1913–1915, amounted to $91,686.15, or whether respondent should have reduced the agreed value of the oil property, amounting to $156,645.00, only by the depletion allowed as a deduction under the revenue act of 1913, which amounted to $6,322.02.

3. The errors committed by the Board of Tax Appeals upon which the petitioner relies as the basis of this proceeding are as follows:

(1) The board erred in determining that, for the purpose of fixing the base upon which the petitioner's depletion allowance for 1918 should be computed, the March 1, 1913, value of petitioner's property, stipulated as $156,645.00, should be reduced by depletion sustained for the period 1913 to 1915, inclusive, amounting to $91,686.15.

(2) The board erred in not finding that the March 1, 1913, value of petitioner's property, amounting to $156,645.00, should be re-
26 duced only by the amount of depletion allowed as a deduction under the revenue act of 1913 for the years 1913 to 1915, inclusive, stipulated as $6,322.02.

Wherefore your petitioner prays that this court may review the action of the Board of Tax Appeals in this cause, reverse the decision of the board, and remand the proceeding for a redetermination based upon the allowance of a deduction for depletion of oil properties computed by reference to a recoverable balance of $150,322.98 at December 31, 1915, and such other factors as may be proper in the premises.

PHIL D. MORELOCK,
Attorney for Petitioner,
710 Land Bank Building, Kansas City, Missouri.

[*Duly sworn to by Phil D. Morelock; jurat omitted in printing.*]

Now, November 6, 1929, the foregoing petition for review, notice of filing and proof of service certified from the record as a true copy.

[SEAL.] B. D. GAMBLE,
Clerk, U. S. Board of Tax Appeals.

Before United States Board of Tax Appeals

Præcipe for record on review

Filed Nov. 1, 1929

To the Clerk of the Board of Tax Appeals:

SIR: You will please incorporate in the transcript to be certified to the Circuit Court of Appeals for the Tenth Circuit in this proceeding the following portions of the record:

27–28 1. The docket entries of proceedings before the board.
2. The pleading before the board.
3. The findings of fact, decision, and opinion of the board.
4. The petition for review.

PHIL D. MORELOCK,
Attorney for Petitioner.
C. M. CHAREST,
General Counsel, Bureau of Internal Revenue,
For Respondent.

Now, November 6, 1929, the foregoing præcipe certified from the record as a true copy.

B. D. GAMBLE,
Clerk, U. S. Board of Tax Appeals.

[File endorsement omitted.]

29 Before United States Board of Tax Appeals

THOMPSON OIL & GAS COMPANY, PETITIONER
vs.
COMMISSIONER OF INTERNAL REVENUE, RESPONDENT
Docket No. 10600

Stipulation enlarging time

Filed in U. S. C. C. A. Nov. 16, 1929

It is stipulated that the time within the clerk of the Board of Tax Appeals may certify the record herein to the Circuit Court of Appeals for the Tenth Circuit be enlarged to November 19th, 1929.

PHIL D. MORELOCK,
Attorney for Petitioner.
C. M. CHAREST,
General Counsel for Respondent.

[File endorsement omitted.]

30–31 [Appearances of counsel omitted in printing.]

32 In United States Circuit Court of Appeals for the Tenth Circuit

THOMPSON OIL & GAS COMPANY, PETITIONER
vs.
COMMISSIONER OF INTERNAL REVENUE, RESPONDENT
No. 192

Stipulation enlarging time

Filed Feb. 19, 1930

It is hereby stipulated and agreed by and between the attorneys for the petitioner and respondent in the above-entitled cause that the time for filing the printed brief on behalf of the respondent be extended to include February 17, 1930, a copy of the manuscript of the brief having been served upon counsel for the petitioner on
33 February 10, 1930, the date on which it was due.

J. S. Y. IVINS,
Attorney for Petitioner.
C. M. CHAREST,
Attorney for Respondent.

[File endorsement omitted.]

In United States Circuit Court of Appeals

[Titles omitted.]

Minute entries

Feb. 20, 1930

This cause comes on to be heard, J. S. Y. Ivins, esquire, appearing as counsel for petitioner.

Thereupon, upon his motion, it is now here ordered by the court that appellant may file twenty copies of a reply brief herein instanter, which is accordingly done.

34 Feb. 21, 1930

This cause comes on to be heard and is argued by counsel, Phil D. Morelock, esquire, and J. S. Y. Ivins, esquire, appearing for petitioner, J. L. Monarch, esquire, appearing for respondent.

Thereupon this cause is submitted to the court.

35 In United States Circuit Court of Appeals, Tenth Circuit

No. 192. February term, 1930

THOMPSON OIL & GAS COMPANY, PETITIONER

vs.

COMMISSIONER OF INTERNAL REVENUE, RESPONDENT

On petition to review the decision of the United States Board of Tax Appeals

Mr. Phil D. Morelock, Mr. J. S. Y. Ivins (Shouse, Doolittle, Morelock & Shrader and Holmes, Brewster & Ivins were with them on the brief), for petitioner.

Mr. J. Louis Monarch, special asst. to the Atty. Genl. (Mr. G. A. Youngquist, Asst. Atty. Genl. Mr. Sewall Key, special asst. to the Atty Genl.; Mr. C. M. Charest, Gen. Counsel, Bureau of Internal Revenue; and Mr. John MacC. Hudson, special atty., Bureau of Internal Revenue, were with him on the brief), for respondent.

Before LEWIS, COTTERAL, and PHILLIPS, Circuit Judges

PHILLIPS, Circuit Judge, delivered the opinion of the court.

Opinion

April 4, 1930

36 This is a proceeding to review a decision of the Board of Tax Appeals. The petitioner was the owner of an oil and gas lease acquired prior to March 1, 1918. On that date its recoverable oil reserves were 278,000 barrels and the value thereof was $156,645. On January 15, 1916, petitioner acquired an extension of

its lease for a consideration of $30,000, which increased its recoverable oil reserves by 300,000 barrels.

The controversy concerns the proper depletion allowance for the year 1918.

The commissioner determines the amount of sustained depletion for a given year as follows: He divides the value of the oil reserves at the beginning of the year, based on their March 1, 1913, value (or their cost, if acquired thereafter) by the number of barrels of oil reserves at the beginning of such year, to obtain in the form of a decimal the rate per barrel of depletion. Such decimal is the amount of capital investment in each barrel of such oil reserves. He multiplies the number of barrels produced in such year by such decimal and thereby arrives at the amount of sustained depletion for that year.

The per barrel depletion unit of petitioner for 1913 was $0.56347. Theoretically the rate per barrel of depletion is determined each year after deducting the depletion for the preceding year from the capital investment and the production for the preceding year from the oil reserves, but unless a part of the oil reserves is sold or new oil reserves are acquired the rate per barrel remains constant.

Employing the above method, the commissioner determined the aggregate of petitioner's sustained depletion for 1913, 1914, and 1915 to be $91,686.15.

The revenue act of 1913 limited the depletion allowance to 5% of the gross income, and under this act the petitioner was entitled to deduct a depletion allowance of $6,322.02 for the years 1913 to 1915, inclusive.

37 Because of the acquisition in 1916 of additional oil reserves a redetermination of the rate per barrel of depletion was necessary. To the value of the oil reserves on March 1, 1913, less the sustained depletion for 1913, 1914, and 1915, the commissioner added the cost of the 1916 acquisition. To the oil reserves on March 1, 1913, less the production for 1913, 1914, and 1915, the commissioner added the additional reserves acquired in 1916. He divided the former result by the latter to obtain the rate per barrel of depletion for 1916. The new per barrel depletion unit was $0.22866. Since there was no change in the oil reserves by purchase or sale after 1916, the decimal remained constant and was applied in determining the depletion sustained for the years 1916 and 1917 and the depletion allowable for the year 1918.

The sustained depletion for 1916 was $11,307.69 and for 1917 was $8,964.39.

Sec. 12 (a) second, of the revenue act of 1916, limited the depletion allowance, in case of an oil and gas well, to "a reasonable allowance for actual reduction in flow and production" instead of the depletion actually sustained.

Paragraph 537 of Regulations 33, revised, provided that when the sum of the credits for depletion should equal the value or cost of

the property no further deduction for depletion would be allowed with respect to such property.

In arriving at the capital investment on January 1, 1918, the commissioner deducted not the allowable but the sustained depletion, which aggregated the sum of $111,958.23.

Counsel for the petitioner contend that the capital investment on January 1, 1918, should have been determined by adding the cost of the 1916 acquisition to the 1913 value of the oil reserves and deducting the allowable, as distinguished from the sustained, depletion for the years 1913 to 1917, inclusive, and that the rate per barrel of depletion for the year 1918 should have been determined by dividing such result by the number of barrels of oil reserves remaining on January 1, 1918, after adding the 1916 acquisition and deducting the production from 1913 to 1917, inclusive; in other words, that allowable instead of sustained depletion should have
38 been used in determining the capital investment in oil reserves on January 1, 1918.

Counsel for the commissioner contend that the capital investment, upon which the depletion allowances provided for by the revenue act of 1918 should be applied, is the value of the oil reserves on March 1, 1913, plus the cost of the 1916 acquisition, less the sustained, as distinguished from the allowable, depletion during the period from 1913 to 1917, inclusive.

The majority opinion of the Board of Tax Appeals upheld the contentions of the commissioner. There was a dissent in which three of the members joined and three other members dissented without opinion.

Sec. 234 of the revenue act of 1918 in part provides:

"(a) That in computing the net income of a corporation subject to the tax imposed by sec. 280 there shall be allowed as deductions: * * *

"(9) In the case of mines, oil and gas wells, other natural deposits, and timber, a reasonable allowance for depletion and for depreciation of improvements, according to the peculiar conditions in each case, based upon cost including cost of development not otherwise deduced: Provided, That in the case of such properties acquired prior to March 1, 1913, the fair market value of the property (or the taxpayer's interest therein) on that date shall be taken in lieu of cost up to that date: Provided further, That in the case of mines, oil and gas wells, discovered by the taxpayer, on or after March 1, 1913, and not acquired as the result of purchase of a proven tract or lease, where the fair market value of the property is materially disproportionate to the cost, the depletion allowance shall be based upon the fair market value of the property at the date of the discovery, or within thirty days thereafter; such reasonable allowance in all the above cases to be made under rules and regulations to be prescribed by the commissioner with the approval

39 of the Secretary. In the case of leases the deductions allowed by this paragraph shall be equitably apportioned between the lessor and lessee."

Art. 201 of Regulations 45, under the revenue act of 1918, in part provides:

"Sections 214 (a) (10) and 234 (a) (9) provides that taxpayers shall be allowed as a deduction in computing net income in the case of natural deposits a reasonable allowance for depletion of mineral and for depreciation of improvements. * * *

"The essence of these provisions of the statute is that the owner of mineral deposits, whether freehold or leasehold, shall within the limitations prescribed, secure through an aggregate of annual depletion and depreciation deductions the return of either (a) his capital investment in the property, or (b) the value of his property on the basic date, plus subsequent allowable capital additions.

"When used in these articles of the regulations covering depletion and depreciation—

"(a) The term 'basis date' indicates the date of valuation, i. e., March 1, 1913, in the case of property acquired prior thereto, the date of acquisition in the case of property acquired on or after March 1, 1913, or the date of discovery, or within 30 days thereafter, in the case of discovery."

Art. 203 of Regulations 45, under the revenue act of 1918, in part provides:

"(a) In the case of a lessee, the capital remaining in any year recoverable through depletion and depreciation deductions is (1) the value as of the basic date of the lessee's equity in the property plus (2) subsequent allowable capital additions but minus (3) depletion and depreciation sustained, whether legally allowable or not from the basic date to the taxable year. The capital recoverable through depletion is the total capital remaining less the sum recoverable through depreciation."

40 Counsel for the petitioner rely upon United States v. Ludey (274 U. S. 295). That case involved the amount of income, under the revenue act of 1916 as amended by the revenue act of 1917, derived from the sale in 1917 of mining properties, including oil reserves, acquired in part prior to March 1, 1913.

Until 1924 none of the revenue acts expressly provided that in computing gain from the sale of property deduction should be made from the original cost on account of depreciation and depletion.

Ludey contended, first, that no deduction should be made from cost on account of depreciation and depletion, and second, if any such reduction were made, it should be the amount claimed by him rather than the greater amount which he might have claimed in his income tax returns.

On the other hand, the Government contended that in the extraction and sale of oil Ludey consumed so much of the equipment as was represented by depreciation and disposed of so much of the

oil reserves as was represented by depletion, and for that reason the amounts of the sustained or actual depreciation and depletion should be deducted from the cost of the property in computing the income resulting from the sale.

The court held that "the theory underlying this allowance for depreciation is that by using up the plant a gradual sale is made of it" and that "the depreciation charged is the measure of the cost of the part which has been sold"; that "when the plant is disposed of after years of use the thing then sold is not the whole thing originally acquired"; that "the amount of depreciation must be deducted from the original cost of the whole in order to determine the cost of that disposed of in the final sale of properties"; that "any other construction would permit a double deduction for the loss of the same capital assets"; and that "the amount of allowance for depreciation is the sum which should be set aside for the taxable year in order that at the end of the useful life of the plant in
41 the business the aggregate of the sum set aside will (with the salvage value) suffice to provide an amount equal to the original cost."

The court further held that the depletion charge, permitted as a deduction from the gross income in determining taxable income of mines for any one year, "represents the reduction in the mineral contents of the reserves from which the product is taken"; that "in essence the deduction for depletion does not differ from the deduction for depreciation"; and that the deduction for depletion "is to be regarded as a return of capital."

The court concluded that the deduction to be made from the original cost on account of depreciation and depletion "should be the aggregate amount which the taxpayer was entitled to deduct in the several years."

Counsel for the petitioner assert that it follows, from the decision in the Ludey case, (1) that depletion and depreciation are the same; (2) that depletion is a gradual sale of the oil reserves; (3) that in determining capital investment as of January 1, 1918, allowable depletion, instead of sustained depletion, should be deducted for the years 1913 to 1917, inclusive.

Counsel for the petitioner further assert that the history of the revenue acts and their several provisions relative to depletion indicate that Congress intended the taxpayer should ultimately receive as depletion allowances the value of his capital investment on January 1, 1913, plus allowable capital additions; that such is the construction of the 1918 act made by art. 201 of Regulations 45; that such capital investment will be returned in the instant case only by the application of the construction for which petitioner contends.

On the other hand, counsel for the commissioner assert that the tax on the product of a mine or oil well is an excise tax and that Congress might legally exact such tax without making any allow-

ance for depletion and cite Stanton v. Baltic Mining Co. (240 U. S. 103) in support of such contention. From such premise
42 they argue that Congress elected in the 1913 act, to limit the depletion allowance to 5% of the gross income, and in the 1916 act to limit the depletion allowance to a reasonable allowance for actual reduction in flow and production, and that by the 1918 act Congress intended to make provision for depletion actually sustained in 1918 and in the years subsequent thereto, and Congress did not intend to provide for allowance in 1918 and the years subsequent thereto for depletion actually sustained but not allowed prior to 1918.

While the Ludey case involved deduction of depletion from cost upon the immediate sale of the entire oil reserves and the instant case involves the depletion allowance upon a gradual sale of a part of the oil reserves, the analogy between them is close, and it is our opinion that the principles laid down in the Ludey case control the instant case.

It is not strictly a question of allowing in 1918 a part of the depletion sustained in the preceding years, but rather one of determining the cost of the reserves remaining on January 1, 1918, for the purpose of computing depletion allowances for that year under the revenue act of 1918. If such depletion results from a gradual sale of the property, and we think it does, then the cost of the oil sold in 1918 should be computed on the basis laid down in the Ludey case. Depletion represents the cost of the oil sold in 1918. Such cost would be the value of the oil reserves on March 1, 1913, plus the cost of the 1916 acquisition, less the allowable depletion for the years 1913 to 1917, inclusive, divided by the number of barrels of oil reserves remaining January 1, 1918, and multiplied by the number of barrels of oil produced in 1918, and would be the depletion allowance for the year 1918. It is true that the result obtained does not reflect the actual cost, because there was a greater sustained depletion; but neither did the application of the rule laid down in the Ludey case reflect the actual cost of the property sold, because there was a greater sustained depletion.

There can be no doubt that once the capital investment or cost of the oil reserves remaining on January 1, 1918, is determined the 1918 act intended a depletion allowance that would return that capital investment by the expiration of the lease term.

The decision of the Board of Tax Appeals is reversed and the proceeding remanded with instructions to redetermine the taxes in accordance with this opinion.

43 In United States Circuit Court of Appeals

192

THOMPSON OIL & GAS COMPANY, PETITIONER
vs.
COMMISSIONER OF INTERNAL REVENUE, RESPONDENT

Petition for review from the United States Board of Tax Appeals—District of Oklahoma

Judgment

April 5, 1930

This cause came on to be heard on the transcript of the record from the United States Board of Tax Appeals for a review of the decision of said board and was argued by counsel.

On consideration whereof it is now here ordered and adjudged by this court that the decision of the said United States Board of Tax Appeals in this cause be, and the same is hereby, reversed, and that this cause be, and the same is hereby, remanded to said United States Board of Tax Appeals with instructions to redetermine the taxes in accordance with the opinion of this court.

44 In United States Circuit Court of Appeals

[Title omitted.]

Motion for order staying mandate

Filed May 8, 1930

Now comes the Commissioner of Internal Revenue, the respondent herein, by his attorney, C. M. Charest, General Counsel, Bureau of Internal Revenue, and moves the court to enter an order herein staying its mandate for a period of three months from the date of the entry of the judgment herein.

In support of this motion the said Commissioner of Internal Revenue respectfully shows to the court that he is considering the advisability of filing in the Supreme Court within the three months' period provided by statute in that respect a petition for certiorari in this cause; that it is highly probably that such petition for certiorari will be filed; and that he believes it undesirable under such circumstances to have the mandate of this court issue in accordance with the general rules of this court.

C. M. CHAREST,
General Counsel, Bureau of Internal Revenue.

[File endorsement omitted.]

45 In United States Circuit Court of Appeals

[Title omitted.]

Order denying motion for stay of mandate

May 14, 1930

This cause came on to be heard on the motion of respondent for a stay of the mandate herein and was submitted to the court.

On consideration whereof it is now here ordered by the court that said motion be, and the same is hereby, denied.

In United States Circuit Court of Appeals

Mandate

UNITED STATES OF AMERICA, *ss:*

The President of the United States of America to the honorable the Members of the United States Board of Tax Appeals, Greeting:

Whereas, lately before you, or some of you, in a cause between Thompson Oil and Gas Company, petitioner, and Commissioner of Internal Revenue, respondent, Docket No. 10600, the decision of the said United States Board of Tax Appeals, entered on March 21, 1929, was in the following words, viz:

46 "Ordered and decided that there is a deficiency of $29,838.44 for the year 1918."

as by the inspection of the transcript of the record of the said United States Board of Tax Appeals which was brought into the United States Circuit Court of Appeals, Tenth Circuit, by virtue of an appeal agreeably to the act of Congress in such case made and provided, fully and at large appears.

And whereas at the February term, in the year of our Lord one thousand nine hundred and thirty, the said cause came on to be heard before the said United States Circuit Court of Appeals on the transcript of the record from the United States Board of Tax Appeals and was argued by counsel.

On consideration whereof it is now here ordered and adjudged by this court that the decision of the said United States Board of Tax Appeals, in this cause be, and the same is hereby, reversed, and that this cause be, and the same is hereby, remanded to said United States Board of Tax Appeals with instructions to redetermine the taxes in accordance with the opinion of this court.

APRIL 5, 1930.

You therefore are hereby commanded that such further proceedings be had in said cause not inconsistent with the opinion and judg-

ment of this court as according to right and justice, and the laws of the United States, ought to be had, the said appeal notwithstanding.

47 Witness the Honorable Charles E. Hughes, Chief Justice of the United States, the 17th day of May, in the year of our Lord one thousand nine hundred and thirty.

ALBERT TREGO,
Clerk of the United States Circuit Court of Appeals, Tenth Circuit.

48 [Clerk's certificate to foregoing transcript omitted in printing.]

49 Supreme Court of the United States

Order allowing certiorari

Filed October 13, 1930

The petition herein for a writ of certiorari to the United States Circuit Court of Appeals for the Tenth Circuit is granted. And it is further ordered that the duly certified copy of the transcript of the proceedings below which accompanied the petition shall be treated as though filed in response to such writ.

[Endorsement on cover:] Filed No. 35210. U. S. Circuit Court of Appeals, Tenth Circuit. Term No. 288. Robert H. Lucas, Commissioner of Internal Revenue, petitioner, vs. Thompson Oil & Gas Company. Petition for a writ of certiorari and exhibit thereto. Filed July 11, 1930. File No. 35210.

SUPREME COURT OF THE UNITED STATES

OCTOBER TERM, 1930

No. ——

ROBERT H. LUCAS, COMMISSIONER OF INTERNAL REVENUE, PETITIONER, v. THOMPSON OIL & GAS COMPANY

Order extending time within which to apply for writ of certiorari

On consideration of the motion of the Solicitor General in the above-entitled cause, and good cause therefor having been shown,

It is now here ordered, That the time within which petition for writ of certiorari may be filed herein be, and the same is hereby, extended for a period of ten days from this date.

WILLIS VAN DEVANTER,
Associate Justice of the Supreme Court of the United States.

Dated this 3d day of July, 1930.